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UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

SAN FRANCISCO DIVISION

UNITED STATES OF AMERICA, et al., Plaintiffs, v. ORACLE CORPORATION Defendant.	CASE NO. C 04-0807 VRW Filed July 8, 2004 **PLAINTIFFS' PROPOSED CONCLUSIONS OF LAW**

1 Conclusions of Law

1.1 Clayton Act Section 7 Standards

1.1.1 Section 7 of the Clayton Act, as amended, bars acquisitions "where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly." 15 U.S.C. § 18. "Section 7 of the Clayton Act was intended to arrest the anticompetitive effects of market power in their incipiency." *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 577 (1967).

1.1.2 "Section 7 itself creates a relatively expansive definition of antitrust liability: To show that a merger is unlawful, a plaintiff need only prove that its effect '*may be* substantially to lessen competition.'" *California v. American Stores Co.*, 495 U.S. 271, 284 (1990). "Congress used the words '*may be* substantially to lessen competition' . . . to indicate its concern with probabilities, not certainties." *Brown Shoe Co. v. United States*, 370 U.S. 294, 323 (1962). A plaintiff need not show "even a high probability" that the proposed transaction will substantially lessen competition. *FTC v. Elders Grain, Inc*., 868 F.2d 901, 906 (7th Cir. 1989) (Posner, J.). "[T]he statute requires a prediction, and doubts are to be resolved against the transaction." *Id.*

1.1.3 The transaction should be enjoined under Section 7 if it has the "potential for creating, enhancing, or facilitating the exercise of market power—the ability of one or more firms to raise prices above competitive levels for a significant period of time." *United States v. Archer-Daniels-Midland Co.*, 866 F.2d 242, 246 (8th Cir. 1988), *cert. denied*, 493 U.S. 809 (1989) (*"ADM"*). In addition to price increases, the exercise of market power can lead to other anticompetitive effects, for example a decline in product or service quality. *See, e.g.*, *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 368-69 (1963).

1.1.4 In *Philadelphia National Bank* the Supreme Court held that "a merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in the market is so

inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects." 374 U.S. at 363. Once "market share statistics" have "made out a prima facie case of a violation of § 7," it is "incumbent upon [the defendant] to show that the market-share statistics gave an inaccurate account of the acquisitions' probable effects on competition." *United States v. Citizens & S. Nat'l Bank*, 422 U.S. 86, 120 (1975). *See FTC v. H.J. Heinz Co.*, 246 F.3d 708, 715 (D.C. Cir. 2000); *Olin Corp. v. FTC*, 986 F.2d 1295, 1305 (9th Cir. 1993); *United States v. Baker Hughes Inc.*, 908 F.2d 981, 982-83 (D.C. Cir. 1990). Nevertheless, "the ultimate burden of persuasion remains with the [plaintiff] at all times." *H.J. Heinz*, 246 F.3d at 715; *Baker Hughes*, 908 F.2d at 983.

1.1.5 It should be noted that "[m]arket share is just a way of estimating market power, which is the ultimate consideration. When there are better ways to estimate market power, the court should use them." *Ball Mem'l Hosp., Inc. v. Mutual Hosp. Ins.*, 784 F.2d 1325, 1336 (7th Cir. 1986). Hence, in addition to indirect evidence of market power, such as market shares and market concentration figures, courts have considered direct evidence of market power in Section 7 cases when available. *See, e.g.*, *FTC v. Swedish Match*, 131 F. Supp. 2d 151 (D.D.C. 2000) (econometric and documentary evidence on the competitive interaction between the merging brands); *FTC v. Staples, Inc.* 970 F. Supp. 1066, 1075-76 (D.D.C. 1997) (econometric and documentary evidence that prices were higher where there were two competitors than where there were three).

1.1.6 In the merger context, the standard under Section 1 of the Sherman Act and Section 7 of the Clayton Act is the same. *United States v. Rockford Mem'l Corp.*, 898 F.2d 1278, 1281-83 (7th Cir. 1990). Courts frequently use direct evidence to evaluate market power in Section One Sherman Act cases. *See, e.g.*, *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 477, 469-71 & n.15 (1992); *FTC v. Indiana Federation of Dentists*, 476 U.S. 447, 460-61 (1986).

1.2 **Relevant Market Definition**

1.2.1 Courts usually begin an inquiry into market power by defining the relevant product and geographic markets. *Rebel Oil Co. v. Atlantic Richfield Co.*, 51 F.3d 1421, 1434 (9th Cir. 1995). However, the "Government is not required to delineate § 7 markets by 'metes and bounds.'" *United States v. General Dynamics Corp.*, 415 U.S. 486, 521 (1974).

1.2.2 Market boundaries are defined by the "reasonable interchangeability of use" or the "cross-elasticity of demand between the product itself and substitutes for it." *Brown Shoe*, 370 U.S. at 325. *See also United States v. E.I. duPont de Nemours & Co.*, 351 U.S. 377, 400 (1956). Markets "must be drawn narrowly to exclude any other product to which, within a reasonable variation in price, only a limited number of buyers will turn." *Times-Picayune Publishing Co. v. United States*, 345 U.S. 594, 612 n.31 (1953). "The proper question to be asked . . . is not where the parties to the merger do business or even where they compete, but where in the area of competitive overlap, the effect of the merger on competition will be direct and immediate." *Philadelphia Nat'l Bank*, 374 U.S. at 357.

1.2.3 "A 'market' is any grouping of sales whose sellers, if unified by a monopolist or a hypothetical cartel, would have market power in dealing with any group of buyers." *Rebel Oil*, 51 F.3d at 1434. *See also Image Tech. Servs., Inc. v. Eastman Kodak Co.*, 125 F.3d 1195, 1203-04 (9th Cir. 1997); *Coastal Fuels of P.R., Inc. v. Caribbean Petroleum Corp.*, 79 F.3d 182, 197 (1st Cir. 1996)*; Olin Corp.,* 986 F.2d at 1299-1300; *California v. Sutter Health Sys.*, 130 F. Supp. 2d 1109, 1120, 1128-32 (C.D. Cal. 2001). The "hypothetical monopolist" test is derived from Supreme Court precedent – *see E.I. duPont de Nemours*, 351 U.S. at 391-92, 400-01 – and has been refined and made operational by government guidelines. U.S. Department of Justice and Federal Trade Commission, *Horizontal Merger Guidelines* § 1, *reprinted in* 4 Trade. Reg. Rep. (CCH) ¶ 13,104 (1992, rev'd 1997) (*"Merger Guidelines"*).

1.2.4 The best evidence of the likely purchaser response to a price increase is the views of consumers of the products. *FTC v. Butterworth Health Corp*. 946 F. Supp. 1285, 1292 (W.D. Mich. 1996), *aff'd*, 1997-2 Trade Cas. (CCH) ¶ 71,863 (6th Cir. 1997).

Relevant Product Markets

1.2.5 "The touchstone of market definition is whether a hypothetical monopolist could raise prices." *Coastal Fuels*, 79 F.3d at 198. Thus, only products that prevent a hypothetical monopolist from significantly increasing price should be included in the relevant market. *See, e.g., United States v. Microsoft Corp.*, 253 F.3d 34, 51-54 (D.C. Cir. 2001) (affirming exclusion of "middleware" and other products from the relevant market for Intel-compatible PC operating systems as, *inter alia*, either too costly or not sufficiently similar to constrain defendant's prices).

1.2.6 Products that are not functionally similar to those sold by the merging firms generally should be excluded from the relevant market. *See id.* at 53-54 (excluding middleware products from the relevant market for operating systems because no such "product could now, or [will] soon, . . . serve as a platform for popular applications [comparable to Microsoft's Windows], much less take over all operating system functions.")

1.2.7 Products do not compete in the same relevant market merely because they offer functionality that is similar to that offered by the products of the merging firms. *See U.S. Anchor Mfg. v. Rule Indus., Inc.*, 7 F.3d 986, 995-96 (11th Cir. 1993); *ADM*, 866 F.2d at 246; *Staples*, 970 F. Supp. at 1074-75, 1078; *United States v. Gillette Co.*, 828 F. Supp. 78, 82-83 (D.D.C. 1993).

1.2.8 Products that are substantially similar to those sold by the merging firms, but which nevertheless would not prevent a hypothetical monopolist from raising prices, should not be included in the relevant market. *See ADM*, 866 F.2d at 246 (holding that sugar was not in the relevant market for high fructose corn syrup, despite being functionally interchangeable, because the price of sugar was sufficiently high that

buyers of high fructose corn syrup would not switch in the event of a five to ten percent price increase).

1.2.9 The appropriate relevant product markets in which to analyze the competitive effects of the proposed acquisition are the high-function FMS and high-function HRM software markets. *Relevant Geographic Market*

1.2.10 The relevant geographic market is defined using the same "hypothetical monopolist or cartel" test used to define a relevant product market. The smallest geographic area in which the hypothetical monopolist could raise prices constitutes a relevant geographic market. *Merger Guidelines* ¶ 1.21. *See also Philadelphia Nat'l Bank*, 374 U.S. at 359 (a geographic market is the "area in which the seller operates, and to which the purchaser can practicably turn for supplies"); *Coastal Fuels*, 79 F.3d at 197-98 (applying hypothetical monopolist test to determine relevant geographic market).

1.2.11 When the relevant competitors in the market can be readily identified, it is not necessary to draw the precise boundaries of the relevant geographic market. *See United States v. Rockford Mem'l Corp.*, 717 F. Supp. 1251, 1277 (N.D. Ill. 1989), *aff'd*, 898 F.2d 1278 (7th Cir.), *cert. denied*, 498 U.S. 920 (1990) ("[A] metes-and-bounds description of the geographic market is not necessary since the identification of the relevant competitors . . . is the aim of defining a geographic market in the first place").

1.2.12 A court can enjoin a proposed merger on the basis of a finding that it would substantially lessen competition in a geographic market broader than that proposed by the Plaintiffs. *See Rockford Mem'l*, 717 F. Supp. at 1262-78 (finding merger unlawful in a market broader than proposed by plaintiff but narrower than proposed by defendants); *California v. American Stores Co.*, 697 F. Supp. 1125, 1129-31 (C.D. Cal. 1988) (enjoining merger without deciding between proffered geographic markets), *aff'd in relevant part*, 872 F.2d 837 (9th Cir. 1989).

1.2.13 The geographic market must "'correspond to the commercial realities' of the industry." *Brown Shoe*, 370 U.S. at 336. "'[I]ndustry or public recognition of the

[market] as a separate economic' unit matters because we assume that economic actors usually have accurate perceptions of economic realities." *Rothery Storage & Van Co., v. Atlas Van Lines*, 792 F.2d 210, 219 n.4 (D.C. Cir. 1986), quoting *Brown Shoe*, 370 U.S. at 325; *see also Olin Corp.*, 986 F.2d at 1299. While these cases referred to the product dimensions of markets, the same principles apply to the analysis of a market's geographic dimensions. *Brown Shoe*, 370 U.S. at 336 ("The criteria to be used in determining the appropriate geographic market are essentially similar to those used to determine the relevant product market.").

1.2.14 In the high-function FMS and HRM software markets alleged in Plaintiffs' Complaint, the economic reality is that consumers in the United States demand that vendors have a sales, marketing, and service organization in the United States. As a practical matter, any producer wishing to sell in the United States must therefore have a presence here. Further, the ability of sellers to price discriminate prevents sales outside the United States from disciplining competition within the United States.

1.2.15 The appropriate geographic market in which to analyze the competitive effects of the proposed acquisition is the United States.

1.3 The Proposed Acquisition Would Substantially Lessen Competition in the Relevant Markets

1.3.1 Once the Government proves, by a preponderance of the evidence, that the merged firms would control a substantial share of a relevant market and that the merger would significantly increase concentration, a presumption arises that the transaction or combination is illegal. *See Citizens & S. Nat'l Bank*, 422 U.S. at 120; *Philadelphia Nat'l Bank*, 374 U.S. at 363; *H.J. Heinz*, 246 F.3d at 715; *FTC v. University Health,* 938 F.2d 1206, 1218 (11th Cir. 1991); *Rockford Mem'l*, 898 F.2d at 1285.

1.3.2 Evidence that a merger will result in the combined firm having a large market share, particularly in cases where there will be fewer than three significant rivals left in the market post-merger, is sufficient to demonstrate a likelihood of anticompetitive effects. *R.C. Bigelow, Inc. v. Unilever N.V.*, 867 F.2d 102, 107-111

(2nd Cir. 1989). Indeed, according to the D.C. Circuit "no court has ever approved a merger to duopoly under similar circumstances." *H.J. Heinz*, 246 F.3d at 717.

1.3.3 A growing number of courts, including courts of this Circuit, apply the *Merger Guidelines'* approach for assessing pre- and post-merger concentration through use of the Herfindahl-Hirschman Index ("HHI"). *See, e.g., H.J. Heinz*, 246 F.3d at 716; *AlliedSignal, Inc. v. B.F. Goodrich Co.*, 183 F.3d 568, 574 (7th Cir. 1999); *American Stores*, 697 F. Supp. at 1128. The HHI for a market is calculated by summing the squares of the individual market shares of all firms participating in the market. *Merger Guidelines* ¶ 1.5. When the HHI is above 1800, and an acquisition would result in an increase of more than 50 points, the acquisition is presumed to be "likely to create or enhance market power or facilitate its exercise." *Id.* ¶ 1.51. "Sufficiently large HHI figures establish [a] . . . *prima facie* case that a merger is anti-competitive." *H.J. Heinz*, 246 F.3d at 716.

1.3.4 Oracle's acquisition of PeopleSoft would significantly increase concentration in the already highly concentrated high-function FMS and HRM software markets. In high-function FMS, the pre-merger HHI is 2,813, and it would rise by 1,020 points to 3,833 post merger; the combined Oracle-PeopleSoft share would be 47.4%. In high-function HRM, the pre-merger HHI is 3,835, and it would rise by 1,872 points to 5,707 post merger; the combined Oracle-PeopleSoft share would be 69.7%. These figures are significantly above the *Merger Guidelines'* thresholds (§ 1.51) for presuming that the transaction would substantially reduce competition.

1.3.5 Even if the relevant geographic market were worldwide, there would only be three suppliers in the market. The pre-merger HHI in such a market would exceed 3,000 (a mathematical certainty with only three sellers in the market), and the post-merger HHI would increase by a substantial amount. Accordingly, the acquisition presumptively harms competition regardless of whether the geographic market is the United States or worldwide.

1.3.6 Transactions that eliminate head-to-head competition in markets with very few competitors generally have been found to result in anticompetitive effects. *See H.J. Heinz*, 246 F.3d at 716-17; *Staples,* 970 F. Supp. at 1083; *Swedish Match*, 131 F. Supp. 2d at 169. The elimination of head-to-head competition is particularly likely to lead to anticompetitive effects if the products of the merging firms are close substitutes for a significant number of consumers. *See FTC v. Libbey, Inc.*, 211 F. Supp. 2d 34, 47-48 (D.D.C. 2002); *Swedish Match*, 131 F. Supp. 2d at 169; *Merger Guidelines* § 2.21.

1.3.7 The evidence presented at trial – including Defendant's discount request forms, customer testimony regarding limited alternatives, expert regression analyses, and a merger simulation analysis – further demonstrates that the elimination of head-to-head competition between Oracle and PeopleSoft will result in substantial anticompetitive effects in the high-function FMS and HRM markets.

1.3.8 The proposed acquisition would likely result in substantial anticompetitive effects, and is accordingly unlawful.

1.4 **Entry or Repositioning Will Not Overcome the Anticompetitive Effects**

1.4.1 Defendant may rebut the presumption of illegality by showing that anticompetitive effects are not likely to result because of other market forces, such as the lack of barriers to entry. *See Baker Hughes*, 908 F.2d at 985-89; *United States v. Syufy Enters.*, 903 F.2d 659, 664-69 (9th Cir. 1990).

1.4.2 The defendant must show that entry would be timely, likely, and of sufficient magnitude to prevent a significant exercise of market power. *See Rebel Oil*, 51 F.3d at 1440 (citing *Merger Guidelines'* "timely, likely, and sufficient" test); *Swedish Match*, 131 F. Supp. 2d at 168-69 (defendant has burden to demonstrate repositioning sufficient to "fill the competitive void that would result if the [defendant] is permitted to acquire [the target company]."); *Merger Guidelines* ¶¶ 2.212 n.23 & 3.0. To be "timely," entry must take place within two years. *See FTC v. Cardinal Health, Inc.*, 12 F. Supp. 2d 34, 55 (D.D.C. 1998) (citing *Merger Guidelines*). To be "likely," entry

must be highly probable and not speculative. *See id.* at 57 ("the likelihood of entry . . . is theoretical at best. For the purposes of this case, the Court cannot engage in speculation"). To be sufficient, entry must offset the increase in price or reduction in output or innovation that otherwise would be caused by the acquisition. *See id.* at 58 (entry must "be sufficient to offset any post-merger pricing practices that would result from a lack of competition").

1.4.3 Defendant has not offered sufficient evidence that entry or repositioning by companies such as Microsoft, Lawson, or AMS would be timely, likely, and of sufficient magnitude to replace the competition lost because of the transaction. Therefore, Defendant's entry defense fails as a matter of law.

1.5 **Efficiencies Will Not Overcome the Anticompetitive Effects of the Transaction**

1.5.1 Once Plaintiffs show that the proposed transaction gives rise to a presumption that anticompetitive effects are likely to result, the Defendant may attempt to rebut this presumption with evidence "that the intended acquisition would result in significant economies and that these economies ultimately would benefit competition and, hence, consumers." *University Health*, 938 F.2d at 1223.

1.5.2 To carry its burden, the defendant must show that the transaction will achieve significant efficiencies that (a) are supported by "credible evidence," *Staples*, 970 F. Supp. at 1089; *see University Health*, 938 F.2d at 1223; and (b) are merger-specific, *H.J. Heinz*, 246 F.3d at 721-22; *Cardinal Health*, 12 F. Supp. 2d at 62-63; *Staples*, 970 F. Supp. at 1090.

1.5.3 In addition, there is no efficiency, and no consumer benefit, from simply reducing output or quality. *See Rockford Mem'l*, 717 F. Supp. at 1290 (headcount reductions may not qualify as efficiencies for antitrust purposes if they "occur not so much because of the economics effected by the merger, but from a drop in production"); 4A Philip E. Areeda, et al., *Antitrust Law* ¶ 974b3, at 64 (rev'd ed. 1998) (noting that "layoffs are not necessarily evidence of efficiencies," particularly when they result from the combined firm "reducing its output in order to reflect newly

acquired market power"). Costs always can be reduced by eliminating one of the merging products, but that is a clear case of an anticompetitive effect, rather than of a consumer-welfare promoting efficiency.

1.5.4 Furthermore, "a merger the effect of which 'may be substantially to lessen competition' is not saved because, on some ultimate reckoning of social or economic debits and credits, it may be deemed beneficial." *Philadelphia Nat'l Bank*, 374 U.S. at 371. Oracle argues that it needs the money it will gain from the transaction to fund its growth and compete with IBM and Microsoft. The law requires that the "efficiency" reverse the anticompetitive effect, not that the transaction will provide some net social benefit. For this reason, Defendant's "technology stack" argument fails as a matter of law.

1.5.5 Defendant has not offered credible evidence that the proposed transaction will result in significant, merger-specific efficiencies sufficient to off-set the anticompetitive effects of the proposed transaction in the relevant markets. Defendant's efficiencies defense therefore fails as a matter of law.

1.6 **The Plaintiff States Have Met Their Standing Requirements**

1.6.1 Section 16 of the Clayton Act authorizes states to seek injunctive relief against threatened loss or damage arising from the proposed acquisition. 15 U.S.C. § 26. *See Georgia v. Pennsylvania R.R. Co.*, 324 U.S. 439, 447 (1945).

1.6.2 The threatened loss or damage from the proposed acquisition gives rise to the Plaintiff States having standing in two different capacities: (1) as *parens patriae* on behalf their citizens and each states' general welfare and economies; and (2) as representatives of government agencies that are past purchasers or likely future purchasers of high-function HRM and FMS software. *See Hawaii v. Standard Oil Co.*, 405 U.S. 251, 259-61 (1972).

1.6.3 The Plaintiff States have satisfied the requirements for standing, and are therefore proper plaintiffs in this case.

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Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on July 8, 2004, I caused a true and correct copy of the foregoing **PLAINTIFFS' PROPOSED CONCLUSIONS OF LAW,** to be served on the individuals listed below.

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